market notes: Crypto's Catapult – The Bitcoin ETF

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1/12/24 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. "What a difference a day made, twenty-four little hours. Brought the sun and the flowers where there used to be rain."[i] I will forever associate this song with the approval of Bitcoin ETFs, triggered by a reflection, seemingly random, but all related. Dinah Washington was a pioneer, jazzing her way through a period of rapid change in the 1950s. Like ETF advocates. What a difference (a bunch of days) made, indeed.

2. It's institutional – that's the new narrative of the crypto cycle. The excitement around a single-asset ETF that is natively digital may seem peculiar. But it's about the signal – bitcoin entering the mainstream is an invitation for institutional engagement from model portfolios to lawmakers. It's the natural balancing act of any change. The mainstream moves to embrace a new genre, and the new genre smooths its edges for mass appeal.

3. How important are institutions anyhow? They dominate. Let's take a look at the US Financial Accounts. The data are clunky, but the spirit is simple – showing the distribution of the $129 trillion assets held in the financial sector. We can illustrate holdings by the types of players (Figure 1). Assets in pensions, banks and funds account for more than 80% of the total! These are institutions working for individuals.

4. It's also interesting to cut the data by asset class. Much is made of the benchmark 60-40% equity-bond portfolio. Financial holdings look nothing like this balance (Figure 2). Debt instruments dominate – bonds and loans account for half of US domestic financial assets. Stocks are a moderate 41%. Cash buffers are more material than conventional wisdom, weighing in at 9% of US holdings across financial sectors.

5. Can we reconcile perception and reality? Certainly. Benchmark portfolios are active wealth management – what people have in mind with balanced portfolios. But there's a lot more to financial assets. ETFs are a modest $7.1 trillion assets, or 5.5% of the US financial sector. Add in mutual funds and the share rises to 25%. These funds are also driven by institutions working for individuals – the ultimate beneficiaries.

6. These metrics cast the Bitcoin ETFs in a different light. Individuals don't manage their financial assets independently. Most if it runs through middle operators like pensions, banks, and funds. True, crypto can provide people with more independence. But that's the evolution of the system, not the first step. And progress starts from a familiar place – institutions who can now easily access bitcoin on behalf of the individuals they serve.

7. Bitcoin ETFs are a gateway. Regulations were already smoothing bitcoin's edges for institutional acceptance long before the SECs thumbs-up. After all, the US Government is one of the largest bitcoin holders, at 207,189 coins. Regulatory action – not investment – drove those holdings.

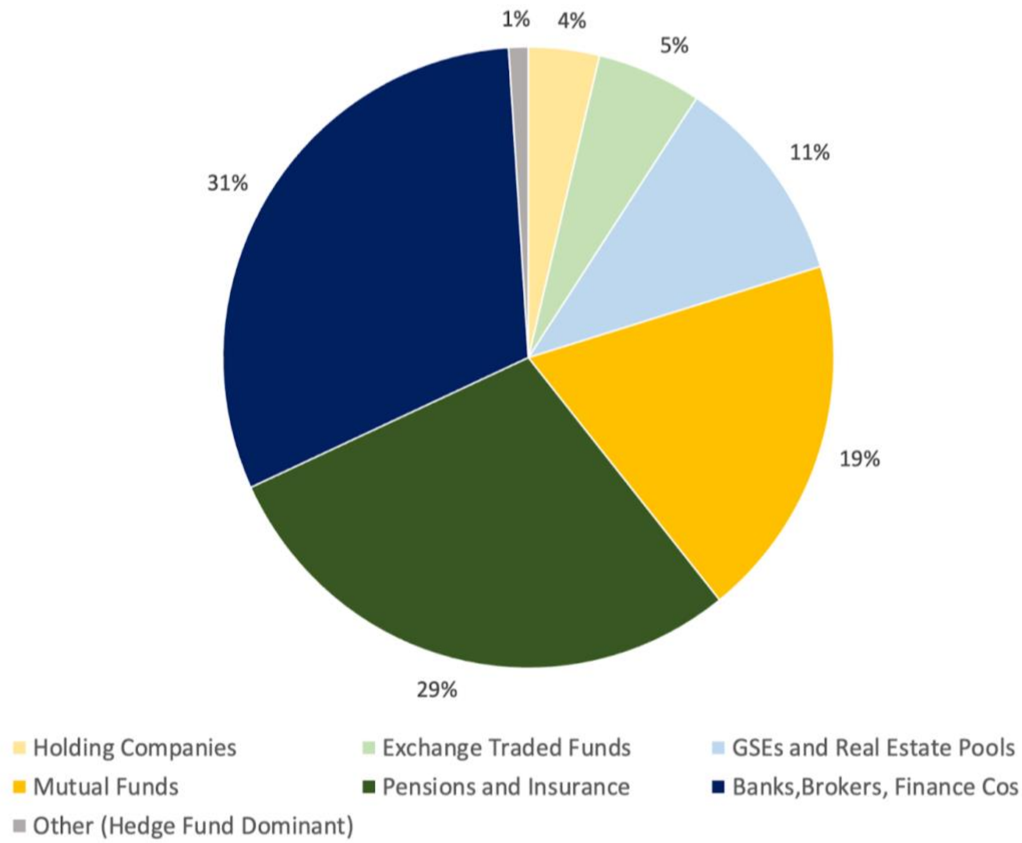
The US Office of Foreign Assets Control is also active, blocking 1,033 bitcoin wallet addresses in its 2,354-page list of sanctions.

8. Bitcoin's smoother regulatory edges invites institutions to engage. But it's not narrowly confined to ETFs. Futures-based crypto ETFs remind players that it may be winner-takes-all – more than 90% of assets are in the largest fund. And a spot ETF, far more cost effective than derivative strategies, could mark the extinction of long-only futures' ETFs. The collective excitement is about a runway to bigger opportunities.

9. What opportunities? Let's go back to the US Financial Accounts for a simple example. There are $157 trillion in total financial assets for the US economy. Nearly $30 trillion assets sit outside of financial sectors like pensions, banks, and funds. Assets like trade and tax receivables are $7.2 trillion of the $30 trillion – the same size as ETFs! These can drive the evolution, ripe for onchain identification and asset management.

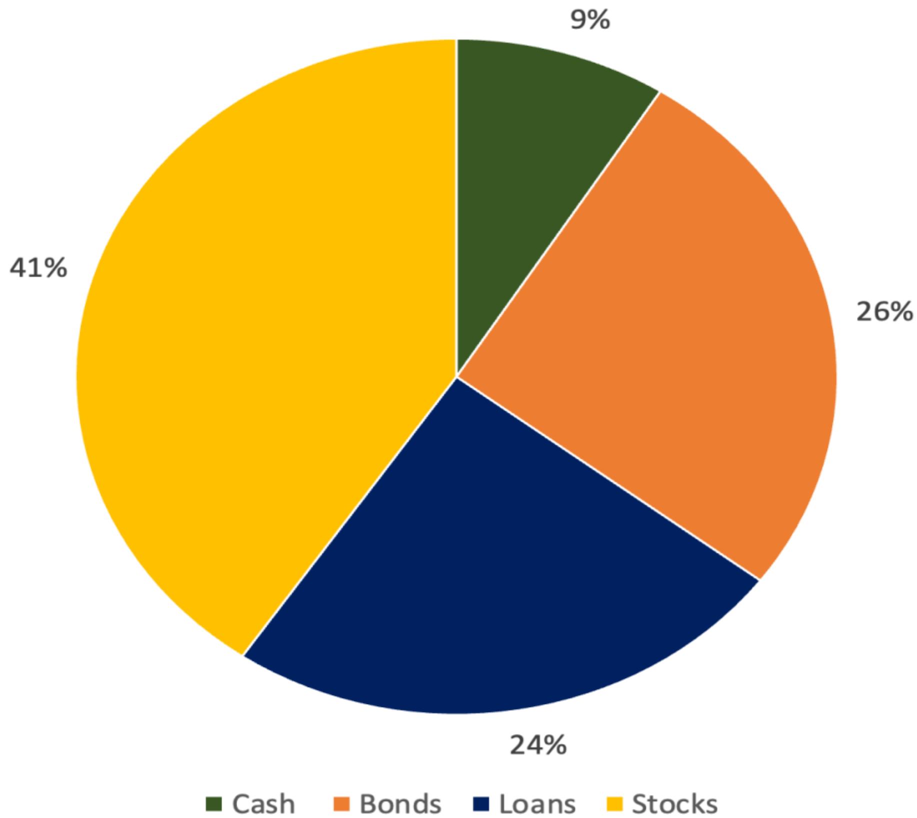
10. The first step of any marathon is the hardest. You commit to start. And a bitcoin ETF is a safe and simple first step. It isn't about prices going up and down in the shorter term. It's about how the financial system can advance to provide better, cheaper, faster services to the ultimate beneficiaries – people. It's natural to start with the familiar. It's a marker to the future. Institutions – regulators and investors alike – have arrived.

Figure 1: US Financial Sector Assets – Institutional Dominance



Source. Federal Reserve. CBAM Calculations.

Figure 2: US Financial Assets by Risk Segment – Debt Dominance



Source. Federal Reserve. CBAM Calculations.

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[i] "**What a Diff'rence a Day Made**", also recorded as **"What a Difference a Day Makes"**, is a popular song originally written in Spanish by María Grever, a Mexican songwriter, in 1934 with the title **"Cuando vuelva a tu lado"** ("When I Return to Your Side") and first recorded by Orquesta Pedro Vía that same year. A popular version in Spanish was later recorded by trio Los Panchos with Eydie Gormé in 1964.The song is also known in English as "What a Diff'rence a Day Makes", as popularized by Dinah Washington in 1959.